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COMMISSIONER'S NOTES

This time of year seems to be a time of change.

In the last month, we have hired three new Bank Examiners in the Consumer Credit Division. Shortly, due to the added responsibility to regulate Money Transmitters, we will be hiring three additional staff. Of course, I am wondering where we will put the new employees, as the office is beginning to bulge at the seams!

In addition, Anne Rabuck, Legal Coordinator for the Banking Division, has left to pursue other interests. We wish her well in those endeavors. She has promised to visit occasionally. Anne will be missed by her fellow employees and, I am sure, by those of you who have worked with her over the past few years. Andrea Shaw will remain a Legal Coordinator but will move from the Consumer Credit Division to the Banking Division. It is also a time of change for the laws we enforce. The legislative process is almost finished and we will soon implement a number of changes to statutes. You should take a few minutes to review Donna Soucy's overview of new legislation that may affect your business. Many of you may be interested in the changes in the trust law and the trust company law. But, there are others dealing with reports of data breaches and credit freezes that are equally important to most of us.

Change also happens in the industries we regulate. I recently attended the annual meetings of both the New Hampshire Credit Union League and the New Hampshire Bankers Association. Those meetings are transitions, too – a look back at what happened and a look forward to what may happen in the coming year. I look forward to working with the new Chairmen of their respective groups – Steve Christy (Mascoma Savings Bank) and Tim Naro (Granite State Credit Union), as we address the challenges of the next year.

So, embrace change and enjoy the summer!



Commissioner Hildreth with students at CU 4 Reality – Berlin Middle School

PERSONNEL CHANGES



Three new employees have joined the Banking Department staff. Joe Rouleau, Lea Sabeau, and Kimberly Grass became Bank Examiners in the Consumer Credit Division. *Pictured above, left to right, Commissioner Peter C. Hildreth, Lea Sabeau, Joe Rouleau, and Kimberly Grass.*

Anne Rabuck, formerly Legal Coordinator for the Banking Division, has left to pursue other interests. We wish her well in her future activities.

Andrea Shaw, Legal Coordinator for the Consumer Credit Division, will assume the same duties in the Banking Division. Andrea's replacement in the Consumer Credit Division has not yet been selected.

LEGISLATIVE UPDATE

Donna M. Soucy, General Counsel

The 2006 Legislative Session has nearly come to an end. All that remains for the House and Senate is a final session day to act on the Governor's vetoes. This was a very busy second year session with well over 1,000 bills considered by the House and Senate. Following are highlights of bills that affect the entities that the New Hampshire Banking Department regulates.

First on our list is **HB 1126, relative to licenses for first mortgage bankers, brokers, pawnbrokers, and money lenders and relative to licensing of money transmitters**. This bill not only makes changes to the regulations for our existing licensees but also adds a new type of entity, money transmitters, to be regulated by the Banking Department. New Hampshire will join the 45 other states that currently regulate money transmitter business. Since the legislation takes effect 60 days after the Governor signs it, the Banking Department projects that money transmitters will be required to obtain a license some time during the month of September. Licenses issued to money transmitters during calendar year 2006 will remain in effect until December 31, 2007.

The legislation also provides for regular examinations of money transmitters, the filing of annual reports and financial statements. We would encourage anyone who believes that they may need a license to engage in this business activity to visit our web site, www.nh.gov/banking in the coming weeks for additional information.

In addition, to the licensing of money transmitters, HB 1126 provides definitions for publicly traded entities and direct and indirect owners of applicants and licensees. These definitions are applicable for all license types issued by the department. The bill also provides additional requirements for reporting significant events to the department. Lastly, the legislation makes clear that the department can request an individual's social security number for the purpose of a licensing investigation.

Another significant piece of legislation effecting the department is **SB 394, establishing the Trust Modernization and Competitiveness Act**. As outlined in our last newsletter, this legislation makes a number of changes to the chartering process for nondepository trust companies and would for the first time authorize the formation of "Family Fiduciary Services Companies." Pursuant to SB 394, existing nondepository trust companies will be required to increase their minimum capital level to \$500,000 and maintain that level.

Other bills of note include **HB 1660, regulating identity theft**, requiring businesses to notify consumers of any

security breach that compromises the confidentiality of their personal information and **SB 334, authorizing the use of a credit freeze as a means of deterring identity theft**, which permits consumers to establish a "credit freeze" on their consumer reports and requires consumer reporting agencies to provide notice of this right as well as permitting victims of identity theft to request copies of their consumer reports. In addition, the House referred to interim study **HB 1374, establishing a committee to require personal information holders to disclose a security a breach**, which means that legislators will continue to study this issue over the summer.

BANKING DIVISION NEWS

Charles M. O'Connor – Chief Bank Examiner

New State Chartered Entity

The Bank Commissioner authorized State Street Global Advisors Capital Management Trust Company, LLC, Nashua, New Hampshire to commence business as a non-depository trust company, beginning on May 23, 2006.

Account Information At-a-Glance

The Bank Commissioner sends out a reminder letter in December and June each year to all state chartered institutions. The form (NHBD-10) is required to be submitted by all state chartered institutions by January 1st and July 1st of each year. BAN 705, available on our website, is the governing regulation. In addition, the form is required to be posted in the lobby of the institution's main office as well as all branches. The form is available on our website and can be emailed to nhbd@banking.state.nh.us when it is complete or you can mail it in.

Interest on Escrow Accounts

The Bank Commissioner sends out a reminder letter in December and June each year to depository institutions to file the Regular Savings Rate Report (Form 384:16-c). From the information received, we calculate the interest rate payable on escrow accounts for the next six month period. RSA 384:16-c and RSA 384:16-e, available on our website, are the governing laws. The form is available on our website and can be emailed to nhbd@banking.state.nh.us when it is complete or you can mail it in.

Emergency Closure of Banks

By Anne J. Rabuck, Staff Attorney

With the recent flooding in the state, the Banking Department would like to draw attention to the provisions of RSA 384-C:3 regarding emergency closures of banks, trust companies, and credit unions. The statute reads as follows:

Whenever the officers of a bank are of the opinion that an emergency exists, or is impending, which affects, or may affect, one or more or all of a bank's offices, they shall have the authority, in the reasonable and proper exercise of their discretion, to determine not to open any one or more or all of such offices on any business or banking day or, if having opened, to close any one or more of all of such offices during the continuation of such emergency. The office or offices so closed shall remain closed until such time as the officers determine that the emergency has ended, and for such further time thereafter as may reasonably be required to reopen; **however, in no case shall such office or offices remain closed for more than 48 consecutive hours, excluding other legal holidays, without requesting the approval of the Commissioner.**

Emergency Contact Form

In order to improve our lines of communication in the event of an emergency, the Department requests that each institution maintain two individuals as emergency contacts. These contacts should be senior level people within the institution, such as President, CEO, COO, or CFO.

The "Emergency Contact Form" is available on our website and should be updated at least semiannually or as information changes. Please include the name, title, direct phone number, home and cell phone numbers, and e-mail address. All information is kept confidential. If you have any questions, please contact Charles M. O'Connor, Chief Bank Examiner at (603) 271-3561.

FDIC Insurance and NCUSIF Share Insurance

By Anne J. Rabuck, Staff Attorney

The Banking Department often receives inquiries regarding deposit insurance. The Spring 2006 FDIC Consumer News included the following information regarding FDIC insurance which banks may want to make available to their customers:

The "Top 10" misconceptions about FDIC insurance. The Number 1 fallacy: The most a consumer can have insured is \$100,000. In fact, a person may qualify for more than \$100,000 in coverage at each insured bank if the funds are deposited in different "ownership categories", such as individual accounts, joint accounts, and certain trust and retirement accounts (refer to recent change to \$250,000 limit for self-directed retirement accounts). Depending on the circumstances, a family of four could have well over

\$1 million in deposit insurance coverage at the same bank — and that coverage is separate from what is FDIC insured at any other institution.

Similar coverage applies to NCUSIF Share Insurance accounts at credit unions.

Duties and Powers of the Trustee

By Chris Blanchette, Bank Examiner

Serving in the role of trustee carries a high degree of fiduciary responsibility in carrying out the provisions of each individual trust instrument. Bank trust departments and non-depository trust companies who accept the role of corporate trustee are held to the highest standards of conduct and professionalism in fulfilling all fiduciary activities. With the implementation of the Uniform Trust Code (NH RSA 564-B), some of the duties and powers of the trustee have been outlined in Article 8 of Section 564-B. The Uniform Trust Code in New Hampshire went into effect on October 1, 2004. Full details of the statute can be found at www.nh.gov.

A question that has come across my desk and that I have encountered in examinations over the past few months deals with a section of Uniform Trust Code in reference to the duties and powers of trustees. NH RSA 564-B:8-813, the Duty to Inform and Report sets the standards for informing beneficiaries of various activities and associated time frames to report. There are provisions that apply to both revocable and irrevocable trusts. The questions and situations I have encountered are in reference to NH RSA 564-B:8-813 (b), which states in part: "A trustee shall keep the qualified beneficiaries of an irrevocable trust who have attained 21 years of age and those having rights of a qualified beneficiary reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests." Although the statute requires that all appropriate parties be informed, there may be circumstances within the trust document or individual situations that may prohibit the divulgence of information or inhibit appropriate account administration. When there is a question regarding providing information to beneficiaries, trustees should seek advice from their legal counsel to help prevent undue risk while ensuring compliance with the Uniform Trust Code and the trust instrument.

Vendor Management Program

By Parker Howell, Bank Examiner

Do you have a comprehensive vendor management program? Have you identified which vendors you consider critical to your institution? Do you know the financial status of those vendors? Do you know what kind of

security program they have? Do you know if they are introducing any new lines of business? If you have answered no to any of these questions then you should review the adequacy and effectiveness of your vendor management program.

A comprehensive vendor management program should encompass two areas. The first is vendor selection and due diligence before a vendor relationship is established. The second is the on-going due diligence or vendor monitoring after the relationship is established. The second area is most overlooked by institutions and will be the focus of this article.

To develop an on-going monitoring or due-diligence program, there are 3 basic steps you should take. These include: identifying all vendors, determining which vendors are critical to your institution, and developing standard monitoring procedures to assess the condition of vendors.

Identify all vendors

Most institutions have already completed this step through either Gramm-Leach-Bliley Act compliance or disaster recovery activities. If you have not done this step, you should get started immediately.

Determine Critical Vendors

Not all vendors are critical vendors. So what differentiates critical vs. non-critical? This is up to each institution to decide. A good practice would be to try to define the attributes or factors that would make a vendor critical. Of course some are “no-brainers” but others may not be so cut and dry. Another area to consider is if the relationship changes, does this change the criticality of the vendor. Some institutions rank the vendor’s criticality when the relationship is first established.

Develop Standard Monitoring Procedures

Now that you know which vendors are critical (or high, moderate, or low risk vendors) then you need to develop procedures for appropriate monitoring. The rule of thumb is that the higher risk, or the more critical a vendor is, then the more review that vendor should receive. A critical vendor may be reviewed every year with the use of audits, SAS 70’s, examination reports etc...while a low risk vendor may be reviewed only every 3 years or as the relationship changes. The scope and frequency of the review is up to each individual institution.

Financial institutions rely heavily on third party vendors, and are becoming more and more dependent upon them. To protect against risks posed by increased outsourcing arrangements, management needs to develop a comprehensive vendor management program that not

only addresses vendor selection but on-going oversight as well. Within the program, management needs to differentiate between critical and non-critical vendors and develop appropriate monitoring procedures commensurate with the criticality of the vendor. For more information, go to www.ffiec.gov or www.fdic.gov.

Quarterly Off-site Banking Review

By Todd Wells, Bank Examiner

The New Hampshire Banking Department initiated a quarterly off-site review process for banks in early 2004. This analysis is designed to identify financial trends among the universe of banks examined by the Department. Examiners may contact bank management to discuss seemingly meaningful measures. The analysis focuses on approximately 30 ratios and measures that correspond to the various financial components evaluated at each examination: capital, asset quality, earnings, liquidity, and sensitivity to market risk. The primary data source is Call Reports/Uniform Bank Performance Reports.

Fourth Quarter 2005

The department’s universe of banks consists of 19 institutions with more than \$14 billion of total average assets.

The average ROA of 0.89% at 4th quarter 2005 (4Q05) shows no significant change from 3Q05. All institutions remain profitable. The average NIM increased 13 basis points (bp) between quarters, reversing the NIM compression observed between 3Q05 and 2Q05.

Asset growth is manageable among the department’s universe of banks with an adjusted average growth rate of 7%. Loan demand remains strong with adjusted average net loan growth near 10% among the universe of banks; the CRE loan category continues to account for nearly ¼ of average gross loans.

Asset quality indicators do not cause concern with an average Past-due Ratio of 1.06% (note that this measure continues to creep upward with a 9bp rise from 3Q05) and an adjusted Noncurrent Loans/Gross Loans Ratio of 0.16% (down 4bp from 3Q05). Seven institutions hold ORE. The office’s banks maintain an average ALLL/Total Loans Ratio of 1.02%. Average reported net losses remain negligible at 0.01% of average total loans.

Average capital ratios remain satisfactory.

Net Non-core Funding Dependence remains a double-digit measure. Several institutions report brokered deposits. Only one institution displays a negative Net Non-core Funding Dependence Ratio.

Expanded Analysis: Annual Statistics

The December 31, 2005 analysis was expanded to produce an annual comparison: 4Q05 with 4Q04. The following bullet points summarize the comparison:

- Total Average Assets grew a moderate 5.6%.
- The Average Tier 1 Risk-Based Capital Ratio was relatively stable.
- Average profitability declined slightly with Average ROA reduced 4.3% to measure 0.89%. However, significant variability occurred among specific institutions.
- Average Net Interest Margin increased 4% to measure 4.14%.
- While the Average Past Due Ratio crept upward from 0.91% to 1.06%, the ratio of Average Net Loss/Average Total Loans declined from an already-low measure and barely registers on the scale at 0.01%.
- The Average ALLL/Total Loans measure was relatively stable.

Other Observation

Recent deposit outflows are observed in nearly half of the institutions examined with most of the deposit reductions occurring after 3Q05. While the overall volume of deposit outflow is not considered substantial, the trend is significant compared to the deposit growth pattern of the past several years.

TRAINING IS NECESSARY

By Robin Boman, Bank Examiner

As regulators, we are asked (with some frequency) whether filing Cash Transaction Reports (CTR) or other reports with FinCEN truly make a difference. The typical response to this question would be to recommend that individual access FinCEN's website, http://www.fincen.gov/le_cases.html to review the **LAW ENFORCEMENT CASES SUPPORTED BY BSA Filings**. The search will provide significant supporting information, discussion, and resulting cases disclosed as a direct result of reports filed.

As you are certainly aware, additional information and resources available on-line are numerous. A site you may want to review and bookmark is the Office of National Drug Control Policy (ONDCP) which recently presented the President's National Drug Control Strategy of February 2006 on its website <http://www.whitehousedrugpolicy.gov/>. The following is an excerpt from that report:

"The United States is making progress in disrupting the illicit drug trade by seizing the profits of drug trafficking. During 2002, law enforcement

agencies seized more than \$696.3 million just in currency and monetary instruments that were destined for foreign drug trafficking organizations.

In 2004, that amount increased to more than \$785.7 million, not including the value of assets seized or currency seized by state and local law enforcement. New initiatives will substantially increase the seizure of trafficker assets and further disrupt the operation of drug trafficking organizations.

Identifying the sender and recipient of illegal funds will help us better understand and target the illegal financial infrastructure of drug trafficking organizations. Federal agencies are strategically refocusing their resources to attack the financial infrastructure of drug trafficking organizations. A strong ally in this attack is the financial sector of our economy, which has been effectively keeping most illegal funds out of our financial institutioning system."

A recent FinCEN advisory (FIN-2006-A003 dated April 28, 2006) was issued to alert U.S. financial institutions of a money laundering threat involving tainted U.S. currency which had been routed in bulk to Mexico, but now is being returned "cleaned" through funds transfers from channels outside of Mexico.

Both the report and the advisory highlight the continuing need to safeguard our financial industry and the diligence required by each and every institution to maintain this effort. It is only through adequate training of personnel that financial institutions will be able to meet this on-going task and ensure compliance with the BSA.

At a minimum, training must be provided for all personnel whose duties require knowledge of the BSA. Training should be ongoing, include regulatory requirements and any related regulations. Further, training should be tailored to the person's specific responsibilities; and, include any changes in regulations, to internal policies, procedures, processes, and monitoring systems.

The training presented should reiterate and enforce the importance which the board and senior management place upon compliance with the BSA and ensure that all employees understand their role in maintaining an effective BSA compliance program.

While the board of directors/trustees may not require the same degree of training as operational personnel, they need to understand the importance of BSA regulatory requirements, the ramifications of noncompliance, and the risks posed to the financial institution. Without a general

understanding of the BSA, the board of directors cannot adequately provide BSA oversight; approve BSA policies, procedures, and processes; or provide sufficient BSA resources.

Financial institutions should document their training programs. Training and testing materials, the dates of training sessions, and attendance records should be maintained by the bank and be available for examiner review. In so doing, the institution will be able to support its efforts in this area.

CONSUMER CREDIT DIVISION NEWS

Mary L. Jurta, Director of Consumer Credit

Mortgage Fraud – What You Can Do To Stop It

By Andrea J. Shaw, Staff Attorney

Mortgage fraud is on the rise in the United States. This poses a significant risk of monetary loss to our country's financial industries and consumers. Many regulators, law enforcement, and industry groups are starting to collaborate to address this increasing problem.

Mortgage fraud is not defined by a state or federal statute. The Federal Bureau of Investigation (FBI) defines mortgage fraud as a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan.

Recent reports indicate mortgage fraud is booming. The FBI has identified 26 states with significant mortgage fraud problems.¹ The FBI has identified 10 states as being "mortgage fraud hot spots". These states have the largest amount of mortgage fraud per capita.²

Fannie Mae studied the amount of mortgage fraud in its loan originations between 2002-2003 and 2004-2005. While there was a slight variance, Fannie Mae found that equity-related misrepresentations accounted for the majority of mortgage fraud.³ The North East marketplace⁴ accounted for 9% of the originations containing fraud in 2002-2003. In 2004-2005 that amount increased to 13%.⁵

¹ *FBI Financial Crimes Report to the Public May 2005.*

² *Id.*

³ Equity-related misrepresentations include asset, property and value misrepresentations, as opposed to credit, social security number, income, and occupation misrepresentations.

⁴ Maine, New Hampshire, Massachusetts, Connecticut, Rhode Island, New York, Pennsylvania, and New Jersey.

⁵ Fannie Mae Mortgage Fraud Statistics, April 2006, www.efannie.com/utility/legal/pdf/fraudstats0406.pdf

There are two main types of mortgage fraud: fraud for housing and fraud for profit. Fraud for housing usually involves a borrower attempting to gain housing by making misstatements on the mortgage application or supporting documents to purchase or refinance a house. The borrower may or may not be coached by an industry insider. This type of mortgage fraud is usually a one time event for the borrower. Once the borrower obtains housing, the borrower lives at that property and does not go out looking for other opportunities to commit mortgage fraud. While this type of fraud poses significant issues for the industry, it is generally not the type of fraud that concerns most regulators due to the nature of the transaction.

Fraud for profit usually involves industry insiders and multiple transactions. Generally, individuals committing this type of fraud do so repeatedly on numerous transactions. A fraud for profit scheme usually involves a mortgage company insider, an appraiser, and may or may not include the borrower. Fraud may be found in multiple areas of the loan application package. Common areas that contain fraud are the borrowers social security numbers, falsified bank statements, falsified earnest money deposits, inflated appraisals, inflated borrower income, false statement of intent to occupy. As with fraud for housing, fraud for profit poses significant risk of loss to the industry. In addition, the borrower may suffer harm as well. Due to the repetitive nature and risk to borrower harm, regulators tend to focus their resources on taking enforcement actions involving fraud for profit.

There are many "red flags" that quality control personnel should look for to lower the risk that your loans contain either type fraud. It can't be stressed enough that the presence of a "red flag" is an indicator that a loan application package may warrant additional scrutiny, not that the loan definitively contains fraud. The following is a partial list of "red flags":

- Buyers' motivation to purchase property not clear (may indicate a "straw buyer")⁶
- Active previous sales history (may indicate a property flip)
- Sales comparables are not consistent upon review of the appraisal
- Discrepancies with other data sources
- Significant cash proceeds
- Exclusive use of one service provider (This varies greatly based on the geographic location and availability of services in the general area surrounding the subject property.

⁶ somebody who purchases property for another person in order to conceal the identity of the real purchaser

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- Income: years in job states as 2 years 1 month (most lenders want additional docs for anything time periods equal or less than 2 years of employment at one job)
 - Early serious delinquencies

Once a “red flag” is identified additional investigation is necessary to determine if fraud is present in the loan or if there is a reasonable explanation for the presence of the “red flag”.⁷

If fraud is detected, contact the New Hampshire Banking Department immediately. The Department can then make any referrals to agencies with criminal authority, if appropriate. This course of action is suggested in large part due to agency restrictions on accepting mortgage fraud cases. For example, the FBI generally accepts only cases involving more than \$350,000.00 in damages. It is quite possible to have loans containing significant fraud that are performing. In that instance, damages are minimal, if you can prove any. The Banking Department is usually interested in any level of fraud taking place at licensees’ companies.

To be effective in combating mortgage fraud, companies need to have a solid quality control program to assist quality control personnel in identifying “red flags”. One of the most efficient ways to accomplish this is to have a written mortgage fraud policy that the entire company understands and has access to.

The first step in designing a mortgage fraud policy is to conduct a risk assessment. This step is essential to illustrate to the company the areas that are most vulnerable

to fraud. For example, a company that offers numerous stated income loans has a substantially different risk profile than a company that only offers fully documented loans. The Banking Department takes no position as to the loan products offered by licensees (so long as they comply with state and federal law), but encourages licensees to understand the risks associated with their product lines and their customer base. The controls in place for those two companies must be different in order to be effective.

Once the vulnerable areas are identified, policies and procedures must be put in place to detect and deal with possible fraud. This includes who an employee should report to internally when “red flags” are identified and how the contact person shall proceed to determine if there is a reasonable explanation for the presence of a “red flag”. Upon the development of those policies and procedures employees need training on how to implement those policies. Last, the company must test the mortgage fraud program and conduct risk assessments periodically to ensure that the program is focused on the appropriate areas and is functioning properly.

Regulators, law enforcement, and the industry must work cooperatively to combat mortgage fraud. The reality of life is no one group or entity has unlimited resources to put towards one issue, no matter how significant the consequences. By working cooperatively, we can cover much more ground and combat mortgage fraud in a way to ensure New Hampshire is never identified as a mortgage fraud “hot spot”.

⁷ other mortgage fraud resources: www.usatrace.com/ssnchart.html; www.mortgagefraud.org; www.appraisalinstitute.org; <http://MBAFightsFraud.MortgageBankers.org>